IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
SAN ANGELO DIVISION

IN RE:	§	
	§	
OPHELIA DELAROSA DAVILA,	§	CASE NO. 00-60316-RLJ-13
	§	
Debtor	§	

OPHELIA DELAROSA DAVILA,	§	
	§	
Plaintiff	§	
	§	
v.	§	ADVERSARY NO. 01-6005
	§	
BENEFICIAL TEXAS, INC.,	§	
HOUSEHOLD FINANCIAL SERVICES,	§	
INC., AND HOUSEHOLD FINANCE	§	
CORPORATION III	§	
	§	
Defendants	§	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Findings of Fact

1. On October 24, 2001, the Debtor, Ophelia Delarosa Davila (as Plaintiff), filed her complaint seeking a determination of the validity and extent of lien, damages, and equitable relief against the Defendants, Beneficial Texas, Inc. (Beneficial), Household Financial Services, Inc., and Household Finance Corporation III (Household Financial Services, Inc. and Household Finance Corporation III will sometimes be referred to collectively as Household). Davila's complaint also objects to the proof of claim filed by Household Financial Services.[1]

[1]A secured proof of claim was filed in the case by Household Financial Services with an address of 636 Grand Regency Blvd., Brandon, Florida. Whether this entity is the same as Household Financial Services, Inc. and/or Household Finance Corporation III is unclear.

2. Davila's claims, as alleged in the complaint, arise from two home equity loans, one in July 1998, the other in May 2000, both secured by Davila's homestead which is legally described as Lot 16, Block 5, Arroya Addition, City of San Angelo, Tom Green County, Texas. The street address is 718 Julian, San Angelo, Tom Green County, Texas.

3. On December 10, 2001, the Defendants, Beneficial and Household, filed their motion to compel arbitration along with a motion to dismiss and their original answer. With respect to the motion to compel arbitration, Beneficial and Household contend that the loan agreements include an enforceable and valid arbitration provision agreed to by the parties and that, pursuant to such agreement and the Federal Arbitration Act, the court should stay the trial of the case until arbitration has been had in accordance with the terms of the agreement.

4. Trial of this adversary proceeding is presently set for the week of May 13, 2002.

5. Hearing on Beneficial's and Household's motion to compel arbitration was held January 15, 2002. After such hearing, the parties submitted additional briefs on the issue and the court took the matter under advisement.

6. By the complaint, Davila contends that both Beneficial and Household violated federal and state laws because of the various costs, charges, and fees incurred by Davila upon closing of the loans. Among the allegations made are that the points and fees charged at closing of the 1998 home equity loan exceed 8% of the amount financed thereby triggering the protections of the Home Ownership and Equity Protection Act of 1994 (HOEPA). Davila further alleged that the charges at closing of both the 1998 and the 2000 home equity loans exceed the 3% cap allowed by the Texas Constitution. Davila seeks the following remedies: an injunction prohibiting Beneficial and Household from foreclosing

Davila's homestead; forfeiture of the remaining principal and interest owing under the loans; recovery of amounts paid to date to the Defendants; avoidance of the lien against the homestead; actual and statutory damages, including damages to which she may be entitled under the Truth in Lending Act (15 U.S.C. § 1600 et seq.), HOEPA, the Real Estate Settlement Procedures Act (RESPA), and the Texas Deceptive Trade Practices Act; recission of the transaction; and setoff against the proof of claim filed by Household. Debtor's Ex. 7.

7. A secured proof of claim was filed by "Household Financial Services" in the principal amount of $34,714.48. Debtor's Ex. 5.[2]

8. The 1998 home equity loan is between Davila as borrower and Defendant Beneficial as creditor and closed on or about July 14, 1998. Davila signed an Adjustable Rate Note reflecting a loan amount of $31,971.53 and calling for monthly installment payments of $394.05 with interest accruing at the rate of 12.5% per annum. In addition, she signed an instrument entitled "Mortgage," granting a mortgage lien in favor of Beneficial against her homestead. The parties do not dispute that this loan was a home equity loan. In fact, the loan documents include a list of disclosures required of home equity loans under section 50, article XVI of the Texas Constitution. Debtor's Ex. 13.

9. The 2000 home equity loan is between Davila as borrower and Household Finance Corporation III as lender and closed on May 1, 2000. In connection with this loan, Davila executed a Texas Home Equity Real Estate Note in the loan amount of $34,800.00, payable to Household Finance Corporation III. In addition, she signed a Texas Home Equity Deed of Trust, granting a lien against her homestead in favor of Household Finance Corporation III, which secures the note and states that the

[2]*See* note 1 *supra*.

debt is an extension of credit defined by section 50(a)(6), article XVI of the Texas Constitution. On the same date, May 1, 2000, Davila signed an arbitration rider, which states as follows:

> This Arbitration Rider is signed as part of your Agreement with Lender and is made a part of that Agreement. By signing this Arbitration Rider, you agree that either Lender or you may request that any claim, dispute, or controversy (whether based upon contract; tort, intentional or otherwise; constitution; statute; common law; or equity and whether pre-existing, present or future), including initial claims, counter-claims, and third party claims, arising from or relating to this Agreement or the relationships which result from this Agreement, including the validity or enforceability of this arbitration clause, any part thereof or the entire Agreement ("Claim"), shall be resolved upon the election of you or us, by binding arbitration pursuant to this arbitration provision and the applicable rules or procedures of the arbitration administrator selected at the time the Claim is filed.

The rider further states that it is "made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act, 9 U.S.C. Sections 1-16 . . . ." Defendant's Ex. 1.

10. The arbitration rider is not signed by the named lender, Household Finance Corporation III. It was, however, signed by Davila in connection with the closing of the 2000 home equity loan and is therefore binding on Davila. Defendants' Ex. 1.

11. The proceeds from the 2000 home equity loan were used to pay off and thereby refinance the 1998 home equity loan. Davila credibly testified that she was unable to pay the 1998 home equity loan and therefore sought relief in the form of a refinancing through her lender, which she understood to be Beneficial.

12. While the court assumes there is some affiliation between Beneficial and Household, no evidence was submitted detailing such affiliation. The court further assumes that Beneficial Texas, Inc., Household Financial Services, Inc., and Household Finance Corporation III are three separate entities.

13. Davila lives at the homestead property with her daughter who is 40 years old, has special

needs, and draws supplemental security income (SSI) because of a disability. Davila is presently unable to work because of her own disability; she testified that she worked on a part- time basis until 1999. At present, she receives, on a monthly basis, $524.00 from Social Security, $350.43 from her husband's retirement, and $175.00 SSI. In addition, her daughter receives $345.00 SSI. Davila's expenses run $1,319.43 a month. Debtor's Ex. 2. Davila's gross income for the years 1996 through 2000 was $14,716.00, $15,903.00, $15,872.00, $14,203.00, and $11,051.00, respectively. *Id.*; Debtor's Exs. 9-10.

14. Davila has filed her final Chapter 13 plan and motion for valuation. By addendum to the plan, Davila states that the claim of Household Financial Services is disputed and that this adversary proceeding has been filed seeking relief from the claim, including avoidance of the lien held by Household Financial Services. Debtor's Ex. 8.

15. If appropriate, these findings of fact shall be considered conclusions of law.

Conclusions of Law

16. The court has jurisdiction over this adversary proceeding under 28 U.S.C. § 1334(b). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (B), (C), (K), and (O).[3]

17. The Supreme Court has held that, "[i]n determining whether statutory claims may be arbitrated, we first ask whether the parties agreed to submit their claims to arbitration." *Green Tree Fin. Corp. - Ala. v. Randolph*, 531 U.S. 79, 90 121 S. Ct. 513, 521 (2000). "[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *Hill v. G.E. Power Sys. Inc.*, – F.3d –, 2002 WL 206335 (5th Cir. 2002),

[3]*See* conclusion 27 *infra*.

quoting AT&T Techs v. Communications Workers, 475 U.S. 643, 648, 106 S. Ct. 1415 (1986).

18. The arbitration rider is between Davila and Household Finance Corporation III and was therefore signed in connection with the 2000 loan. Because Davila did not enter into an arbitration agreement with Beneficial, Davila cannot be compelled to arbitrate any claim she has arising from the 1998 loan. *See Hill*, – F.3d –, 2002 WL 206335.[4]

19. As a general rule, if a valid arbitration provision exists and covers the disputed issue, the Federal Arbitration Act mandates enforcement of the provision. *See Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226-27, 107 S.Ct. 2332, 2337-38 (1987).[5] But, as noted by the Supreme Court in *McMahon*, the required enforcement of an arbitration provision "may be overridden by a contrary congressional command. The burden is on the party opposing arbitration, however, to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue. If Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such an intent 'will be deducible from [the statute's] text or legislative history' or from an inherent conflict between arbitration and the statute's underlying purposes." *Id.* (internal citations omitted), *quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 628, 105 S.Ct. 3346, 3354 (1985).

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[4]A non-signatory may be bound by an arbitration agreement when the non-signatory sues on the contract containing the arbitration provision, or when the non-signatory is a third-party beneficiary to a contract with an arbitration provision. See *Fleetwood Enters. Inc. v. Gaskamp*, – F.3d – , 2002 WL 1000434 *3 (5th Cir. 2002). Neither of these situations is implicated by the facts in the instant case. Davila's claims against Beneficial do not arise from her contract with Household and Davila is not suing on the contract that contains the arbitration agreement. Similarly, Davila is not a third-party beneficiary to the contract containing the arbitration agreement, as a third-party beneficiary is defined as "[o]ne for whose benefit a promise is made in a contract *but who is not a party to the contract*." BLACK'S LAW DICTIONARY 1327 (5th ed. 1979)(emphasis added).

[5]In *McMahon*, the Supreme Court is referring specifically to section 3 of the Federal Arbitration Act (9 U.S.C.). In addition, the parties do not dispute the applicability of the Federal Arbitration Act. The Federal Arbitration Act applies to any valid, written arbitration provision in "a contract evidencing a transaction involving commerce." 9 U.S.C. § 2 (1998); *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 512 U.S. 265, 115 S.Ct. 834 (1995).

20. In the instant case, absent consideration of the bankruptcy filing, the court perceives no inherent conflict between the Federal Arbitration Act and any other "contrary congressional command." *McMahon*, 482 U.S. at 226, 107 S.Ct. at 2337. Were there no bankruptcy filing, Davila's claims against Household would be subject to arbitration.

21. The Fifth Circuit has addressed the issue of the bankruptcy court's discretion to stay a bankruptcy adversary proceeding where the underlying dispute is covered by a contractual arbitration provision. *See Insurance Co. of N. Am. v. NGC Settlement & Asbestos Claims Mgmt. Corp. (In the Matter of National Gypsum Co.)*, 118 F.3d 1056, 1069 (5th Cir. 1997). In *National Gypsum*, Asbestos Claims Management Corporation (ACMC) and NGC Settlement Trust (Trust), successors to National Gypsum Company, a Chapter 11 debtor, initiated an adversary proceeding against Insurance Company of North America (INA) asserting that INA's collection efforts on pre-confirmation debts violated the terms of the confirmed Chapter 11 plan and the Chapter 11 discharge injunction issued upon confirmation. *Id.* At 1059-60. INA filed a motion to stay the adversary proceeding based on a contractual arbitration provision. *See id.* at 1060. As stated by the Fifth Circuit, the dispute there "concerned matters central to [the debtor's] confirmed reorganization plan and implicated contractual issues in only the most peripheral manner (if at all) . . . ." *Id.* at 1067.

22. The Fifth Circuit in *National Gypsum* rejected the core/non-core test advanced by ACMC and the Trust. Under this test, a proceeding, if determined to be core,[6] is deemed to inherently conflict with the Bankruptcy Code, thereby suggesting non-enforcement of an arbitration provision:

> ACMC and the Trust urge us to adopt a position that categorically finds arbitration of core

[6]*See* 28 U.S.C. § 157(b)(2).

bankruptcy proceedings inherently irreconcilable with the Bankruptcy Code. Cognizant of the Supreme Court's admonition that, in the absence of an inherent conflict with the purpose of another federal statute, the Federal Arbitration Act mandates enforcement of contractual arbitration provisions, we refuse to find such an inherent conflict based solely on the jurisdictional nature of a bankruptcy proceeding.

Id. at 1067 (internal citation omitted).

23. The Fifth Circuit in *National Gypsum* further stated as follows:

[W]e believe that nonenforcement of an otherwise applicable arbitration provision turns on the underlying nature of the proceeding, *i.e.*, whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and, if so, whether arbitration of the proceeding would conflict with the purposes of the Code. In this regard, we agree with INA that the discretion enjoyed by a bankruptcy court to refuse enforcement of an otherwise applicable arbitration provision depends upon a finding that the standard set forth in *McMahon* has been met. But because we believe that ACMC and the Trust's declaratory judgment complaint--which concerned matters central to National Gypsum's confirmed reorganization plan and implicated contractual issues in only the most peripheral manner (if at all)--met this standard, we conclude that the Bankruptcy Court was within its discretion to refuse to order arbitration of the adversary proceeding (which was limited to the effect, if any, of National Gypsum's confirmed reorganization plan and attendant injunctions on INA's collection efforts).

. . . .

"[U]nder the Supreme Court precedents there is discretion but in the bankruptcy context there must be a demonstrated specific conflict between enforcing an arbitration clause and the textual provisions and/or purposes of the Bankruptcy Code to justify the exercise of discretion by a bankruptcy court in refusing to enforce an arbitration clause." [Quoting In re Chorus Data Sys. Inc., 122 B.R. 845, 851 (Bankr. D.N.H. 1990.]

. . . .

We think that, at least where the cause of action at issue is not derivative of the pre-petition legal or equitable rights possessed by a debtor but rather is derived entirely from the federal rights conferred by the Bankruptcy Code, a bankruptcy court retains significant discretion to assess whether arbitration would be consistent with the purpose of the Code, including the goal of centralized resolution of purely bankruptcy issues, the need to protect creditors and reorganizing debtors from piecemeal litigation, and the undisputed power of a bankruptcy court to enforce its own orders.

Id. at 1067-1069.

24. The *National Gypsum* case does not squarely address the issue before the court. Here, the court is faced with claims that are arbitrable and claims that are not arbitrable – both within the context of a Chapter 7 bankruptcy proceeding.

25. The court cannot compel arbitration of Davila's claims against Beneficial. On the other hand, to deny arbitration of Davila's claims against Household, the court must conclude that there is an "inherent conflict between arbitration and the [Bankruptcy Code's] underlying purposes." *McMahon*, 482 U.S. at 226-27, 107 S.Ct. at 2337-38.

26. Echoing *McMahon*, the Supreme Court in *Rodriguez De Qujas v. Shearson/American Express, Inc.*, 490 U.S. 477, 483, 109 S.Ct. 1917, 1921 (1989) stated that "the party opposing arbitration carries the burden of showing that Congress intended in a separate statute to preclude a waiver of judicial remedies or that such a waiver of judicial remedies inherently conflicts with the underlying purposes of that other statute."

27. While opinions from the Supreme Court, the Fifth Circuit, and the District Court for the Northern District of Texas have all mandated that arbitrable claims be severed from nonarbitrable claims, none of these opinions have addressed this issue in the bankruptcy context. *See Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 217, 105 S.Ct. 1238, 1241 (1985); *Hill*, – F.3d –, 2002 WL 206335 at *2-*3; *Tai Ping. Ins. Co. v. M/V Warschau*, 731 F.2d 1141, 1145-46 (5th Cir. 1984); *Almell Prods. Ltd. v. Seche Inc.*, 1996 WL 734916 *2 (N.D. Tex. 1996).

28. Davila's claims against Household (and Beneficial) do not arise exclusively from the

Bankruptcy Code. However, resolution of such claims does concern the administration of Davila's bankruptcy estate, the allowance or disallowance of claims against the bankruptcy estate, claims by the Debtor Davila against a party, Household, that has filed a claim against the estate, a determination of the validity of liens, and the adjustment of the debtor/creditor relationship. This adversary proceeding is therefore a core proceeding. *See* 28 U.S.C. § 157(b)(2)(A), (B), (C), (K), and (O). While the core/non-core distinction is not dispositive, it is not irrelevant.

29. Were this case not complicated by the severability question – i.e. Davila's claims against Beneficial not being arbitrable while her claims against Household are – and by Davila's bankruptcy, the court would have no discretion to deny arbitration of Davila's claims against Household. *See In the Matter of National Gypsum Co.*, 118 F.3d at 1067. Efficiency concerns raised by the bankruptcy filing and the severability issue do create a potential conflict between the Bankruptcy Code and the Federal Arbitration Act. The Fifth Circuit recognized this in *National Gypsum* when it stated as follows:

> [t]he Supreme Court has stated that efficiency concerns are not an appropriate defense to an otherwise applicable arbitration clause. In the bankruptcy context, however, efficient resolution of claims and conservation of the bankruptcy estate assets are integral purposes of the Bankruptcy Code. Accordingly, insofar as efficiency concerns might present a genuine conflict between the Federal Arbitration Act and the Code – for example where substantial arbitration costs or severe delays would prejudice the rights of creditors or the ability of a debtor to reorganize – they may well represent legitimate considerations.

Id. at 1069 n. 21.

30. One of the central purposes of bankruptcy is the expeditious settlement of a debtor's claims. *See Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.*, 474 U.S. 494, 508, 106

S.Ct. 755, 763 (1986)(Rehnquist, J., dissenting). "[T]his Court has long recognized that a chief purpose of the bankruptcy laws is to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period." *Katchen v. Landy*, 382 U.S. 323, 328, 86 S.Ct. 467, 472 (1966). *See also Oppenheim, Appel, Dixon & Co. v. Bullock (In the Matter of Robintech Inc.)*, 863 F.2d 393, 397-98 (5th Cir. 1989)("The purpose of the bankruptcy laws is quickly and effectively to settle bankrupt estates").

31. Although claims raised by this adversary do not arise exclusively from rights conferred by the Bankruptcy Code, severance of the claims to allow arbitration of Davila's claims against Household and trial of her claims against Beneficial would clearly frustrate the integral purposes of bankruptcy mentioned above. This case is presently set for trial during the week of May 13, 2002. If Davila's claims against Household were sent to arbitration, the court would likewise delay the trial of her claims against Beneficial pending arbitration. A resolution of all issues would therefore extend well beyond the present trial date. Piecemeal litigation increases costs, including the cost of an arbitrator, thereby potentially diminishing the bankruptcy estate to the detriment of other creditors.

32. The additional cost of piecemeal litigation, particularly the cost of an arbitrator, is of particular concern to the court. Davila has a limited and fixed income. By this Chapter 13 proceeding, she is seeking to repay a portion of her debts over 60 months. *See* Debtor's Ex. 8. The court does not find that Davila's share of the arbitration costs effectively precludes her from pursuing her claims;[7] but

[7]An otherwise enforceable arbitration agreement may not be enforced when the cost of arbitration effectively precludes redress of federal statutory claims. *See Green Tree Fin. Corp. - Ala. v. Randolph*, 531 U.S. 79, 90, 121 S. Ct. 513, 522 (2000) ("It may well be that the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum."); *Williams v. Cigna Fin. Advisors Inc.*, 197 F.3d 752, 763 (5th Cir. 1999). "[A]n arbitral cost allocation scheme may not be used to prevent effective vindication of federal statutory claims." *Williams*, 197 F.3d at 763. "Arbitration of statutory claims is only effective if

the court does consider the costs of arbitration as a factor in determining whether a trial before the bankruptcy court of all claims raised in this case is a more efficient disposition of the case.

33. Although Davila has claims arising from two loans and against different parties, there are many aspects of the suit that favor a resolution in one forum with all parties joined. Both transactions giving rise to the suit concern home equity loans secured by Davila's homestead. The second loan – the 2000 loan – was used to refinance the first loan. Moreover, there is an apparent affiliation between Beneficial and Household; the same attorney represents Beneficial and Household. Finally, the claims against Beneficial and Household are based on the same legal theories. Under all practical considerations, the claims should be litigated in one proceeding.

34. While arbitration of Davila's claims against Household would frustrate the purposes of the Bankruptcy Code, the converse is not true – denying arbitration of such claims would not frustrate the goals of the Federal Arbitration Act. The purpose of the Federal Arbitration Act (and thus of requiring arbitration) is to vindicate and enforce private contractual arbitration provisions thereby effecting a speedy and cost effective means of resolving claims. *See Volt Info. Sciences Inc. v. Board of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468, 474, 109 S.Ct. 1248, 1253 (1989) (Federal Arbitration Act enacted to "place such [arbitration] agreements upon the same footing as other contracts")*; Deloitte Noraudit A/S v. Deloitte Haskins & Sells U.S.*, 9 F.3d 1060, 1063 (2d Cir.

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potential litigants have an adequate forum in which to resolve their statutory claims. But if the terms of the arbitration agreement actually prevent an individual from effectively vindicating his or her statutory rights, litigants do not have an adequate forum and the policies behind the statute are not served." *Jones v. Fujitsu Network Communications Inc.*, 81 F.Supp.2d 688, 692-93 (N.D. Tex. 1999)(citations omitted) (denying arbitration based on its prohibitive cost). Additionally, even if an arbitrator has the power to award arbitration fees to the prevailing party, it is unlikely that a party that cannot pay for the costs of arbitration "will risk advancing those fees to access the arbitral forum when faced with a mere possibility of being reimbursed." *Id., citing Shankle v. B-G Maint. Mgmt. of Colo. Inc.*, 163 F.3d 1230, 1235 n. 4 (10th Cir. 1999).

1993) ("arbitration is to be encouraged as a means of reducing the costs and delays associated with litigation"). Reducing costs and delays are likewise integral policies of the Bankruptcy Code. *See Oppenheim, Appel, Dixon & Co. v. Bullock (In the Matter of Robintech Inc.),* 863 F.2d 393, 397-98 (5th Cir. 1989).

35. Denying arbitration here does frustrate Household's contractual right to arbitrate. However, the purposes accomplished through arbitration – an efficient and expeditious resolution of the dispute – is likewise served by trial before the bankruptcy court. Severance of the claims and piecemeal litigation fails to satisfy the goals of either the Bankruptcy Code or the Federal Arbitration Act.

36. The motion to compel arbitration will be denied.

37. The court will prepare an appropriate order.

38. If appropriate, these conclusions of law shall be considered findings of fact.

SIGNED March 28, 2002.

ROBERT L. JONES
UNITED STATES BANKRUPTCY JUDGE